
Testimony of Stephen E. Howard

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Before the:

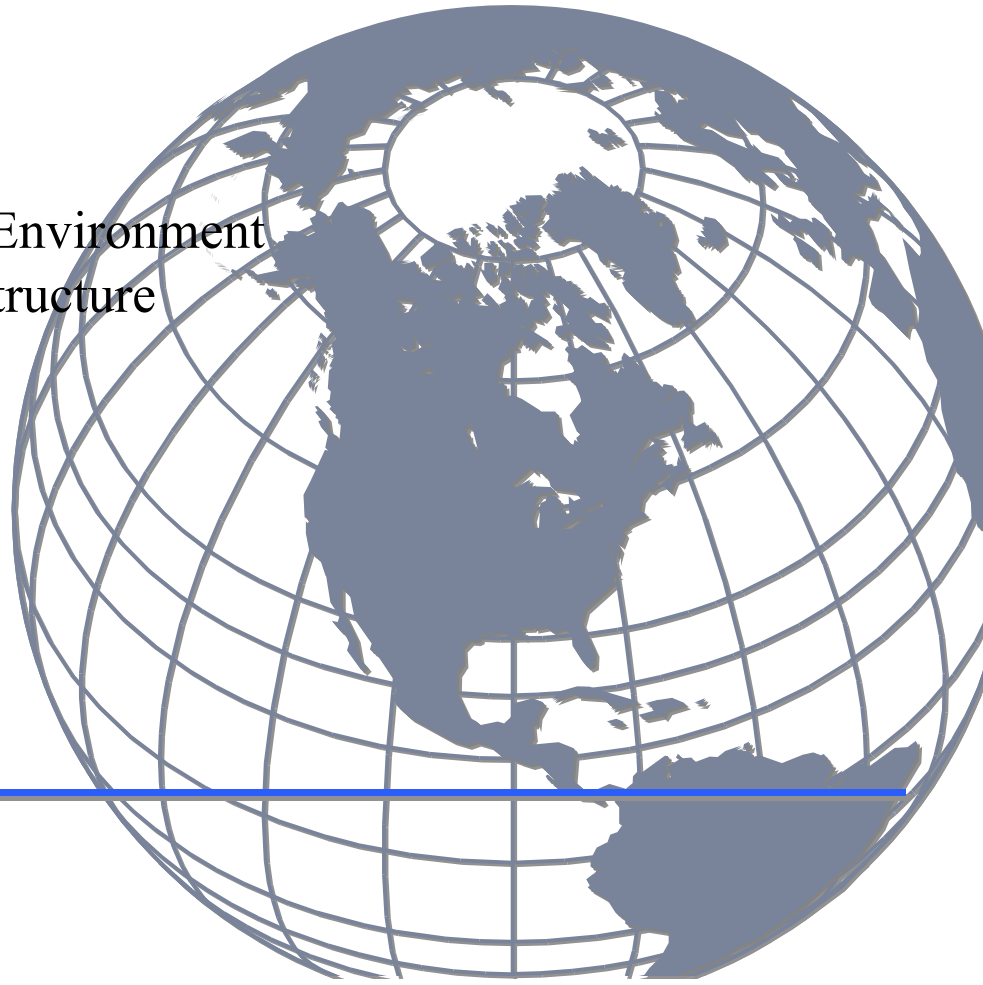
Subcommittee on Water Resources and Environment

Committee on Transportation and Infrastructure

U.S. House of Representatives

Financing Water Infrastructure Projects

June 14, 2005



Introduction

Mr. Chairman and members of the Subcommittee, I am Stephen Howard, representing Lehman Brothers. On behalf of Lehman Brothers, we are very grateful to appear before you today and offer our thoughts on possible tools to help bridge the funding gap that exists with the country's water quality infrastructure needs. I have been at Lehman Brothers for 22 years during which period I have financed over \$7 billion of water, solid waste, transportation, and public facility infrastructure projects in the tax-exempt and taxable bond markets.

During last week's hearing, I understand that the challenge that was put to the witnesses was to provide a viable solution to meet our nation's water quality infrastructure funding needs. I am here today to offer what I believe is part of a viable solution. At the outset, I want to state that no single solution exists to address the enormous demands to finance our water quality infrastructure needs. As a nation, we will need to ensure that the financing "tool box" has as many traditional and innovative financing tools so that local communities can finance the facilities that are mandated by state and federal water pollution control laws and regulations.

Introduction (Continued)

As a starting point, the subcommittee is to be congratulated for recognizing that the existing framework to finance water quality infrastructure needs to be expanded and new financing models must be designed. Last week's hearing on this matter illustrated that consensus remains elusive on how we should proceed, but it was clearly demonstrated by the witnesses that we need new financing models. Whether the new financing models involve grants, loans, loan guarantees, or tax exempt financing, the key is to ensure that our local communities have the latitude to formulate financing strategies which can meet local needs and alleviate the financing burdens of federal mandates that local communities must comply with and ultimately pass on to the American ratepayer.

Today, I want to present some thoughts on one tool that could be added to the financing tool box that could provide an immediate benefit to the priority of unleashing capital to construct water quality infrastructure. I would also like to note that legislation has been introduced on this tool that is pending before the House Committee on Ways and Means. This bill would amend existing tax policy to allow local communities to leverage the capital markets in combination with other financing mechanisms.

Introduction (Continued)

Essentially, H.R. 1708 would provide for the unfettered use of tax exempt securities known as exempt facility bonds or private activity bonds (“PABs”) to finance water quality infrastructure projects. An important aspect of this financing tool is that it would not, according to the Joint Tax Committee, significantly affect the federal treasury. Stated another way, there would be a negligible impact upon the federal budget.

I would encourage the subcommittee members to review this legislation and consider cosponsoring the bill as a means to help address our water quality infrastructure funding gap.

I would like to take the remaining time that I have today and explain how this tool works and to offer a real world example that illustrates that how a scarcity in environmental infrastructure assistance was met using PABs and thus addressed an environmental protection compliance issue.

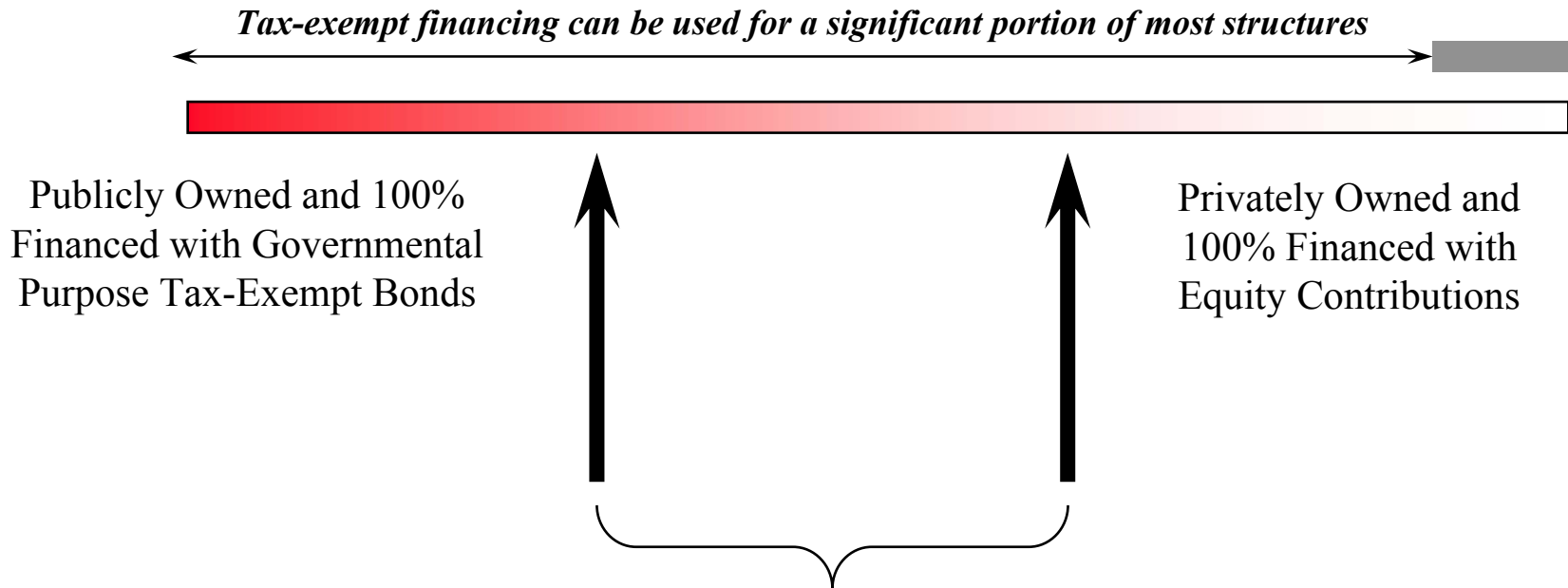
Financing Options for New Infrastructure Projects

- Tax-Exempt Bonds
 - Governmental Purpose Bonds: Limits private participation
 - Private Activity Bonds: Allows private participation
- Taxable Bonds: Unlimited use, but potentially higher all-in cost
- Private Equity: Can be used in conjunction with certain types of Tax-Exempt Private Activity Bonds and all Taxable Bonds

Tax-exempt private activity bonds are typically used on project financed public-private partnership transactions and are repaid by rate payers through retail or wholesale user fees.

Financing Options for New Infrastructure Projects

- There is a broad spectrum of project financing options:



Between these two extremes, a variety of financing structures utilizing tax-exempt private activity bonds, taxable bonds and equity funding are possible to help optimize project development.

Tax-Exempt Financing Availability

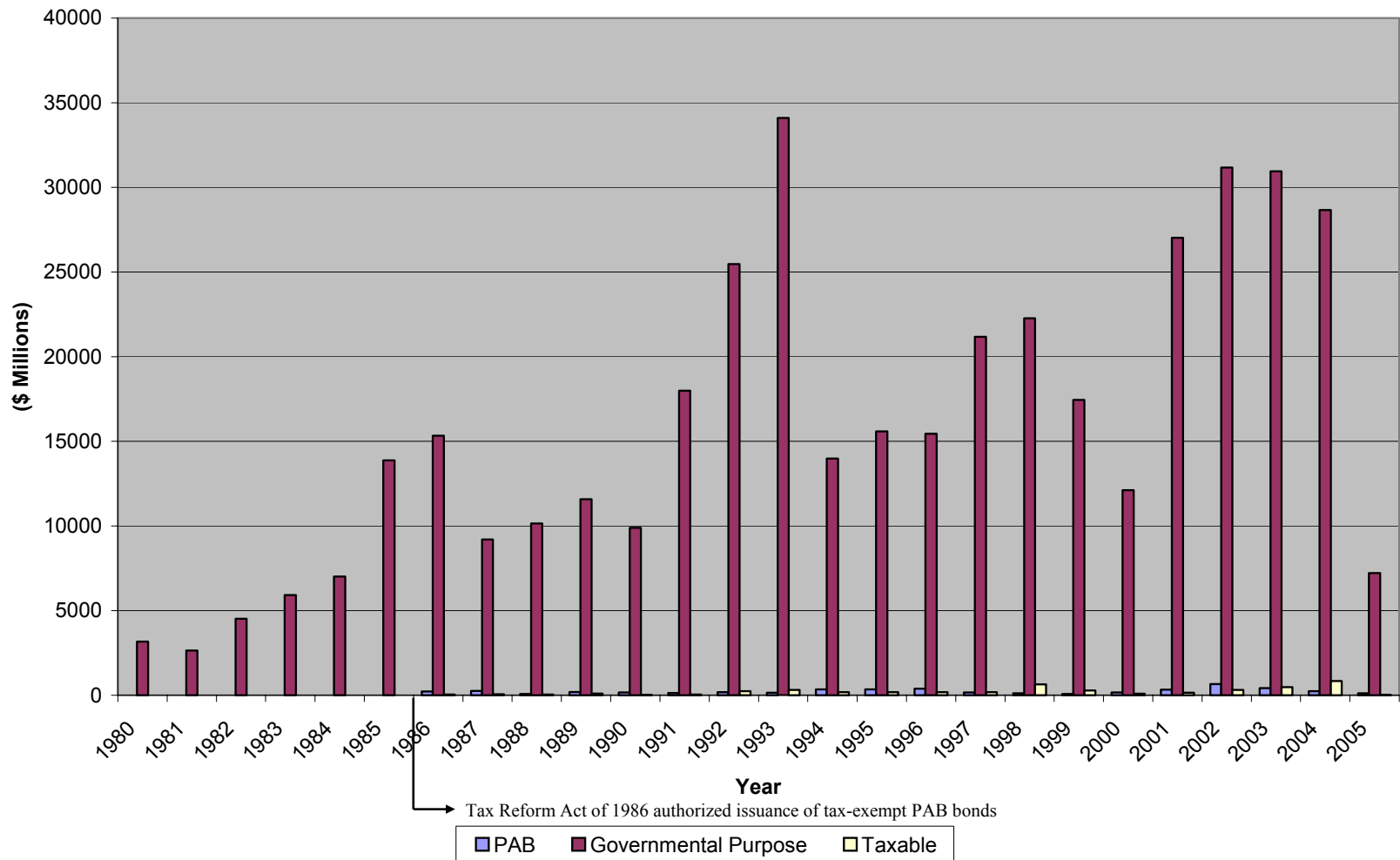
<i>Type of Tax-Exempt Bond</i>	<i>Governmental Purpose Bond Cap Not Required</i>	<i>Private Activity Bond Cap Not Required</i>	<i>Private Activity Bond Cap Required</i>
Ownership	Public	Public	Private
Asset Class			
Public Facilities	✓		
Water/Wastewater	✓		✓
Solid Waste	✓	✓	✓
Airport	✓	✓	
Surface Transportation	✓		
Ports	✓	✓	
Housing	✓		✓
Education	✓		
Healthcare	✓		

Projected Water/Wastewater PAB Issuance

- In order to project the amount of water/wastewater PAB issuance if PAB cap allocation is eliminated, an analogy can be made with the municipal solid waste sector
- The municipal solid waste sector faced a “crisis” in the early 1980’s due to declining landfill capacity and rapidly increasing disposal costs
- The US Congress responded to this crisis by eliminating tax-exempt private activity bond cap for municipal solid waste disposal projects in the Tax Reform Act of 1986
- As a consequence, over \$15 billion of PAB’s have been issued since 1986 to help fund the development of new infrastructure to help solve the municipal solid waste disposal crisis

Water/Wastewater Historical Data

Transaction Amounts Over Past 25 Years

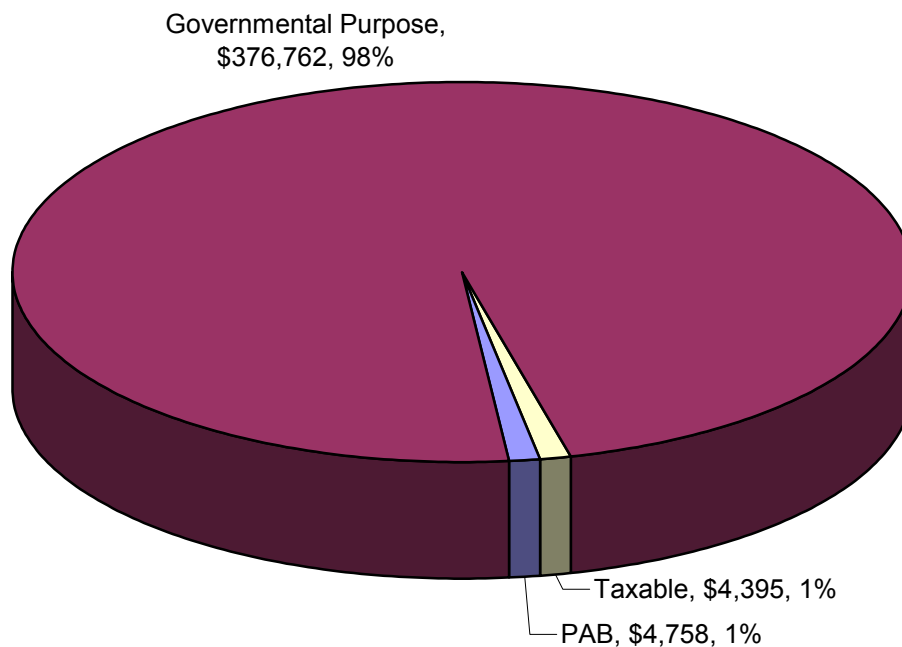


Water/Wastewater Historical Data

Water/Wastewater Transaction Allocation (\$ Millions)

Total Issuance: \$385,915 Million

Years: 1986-2005

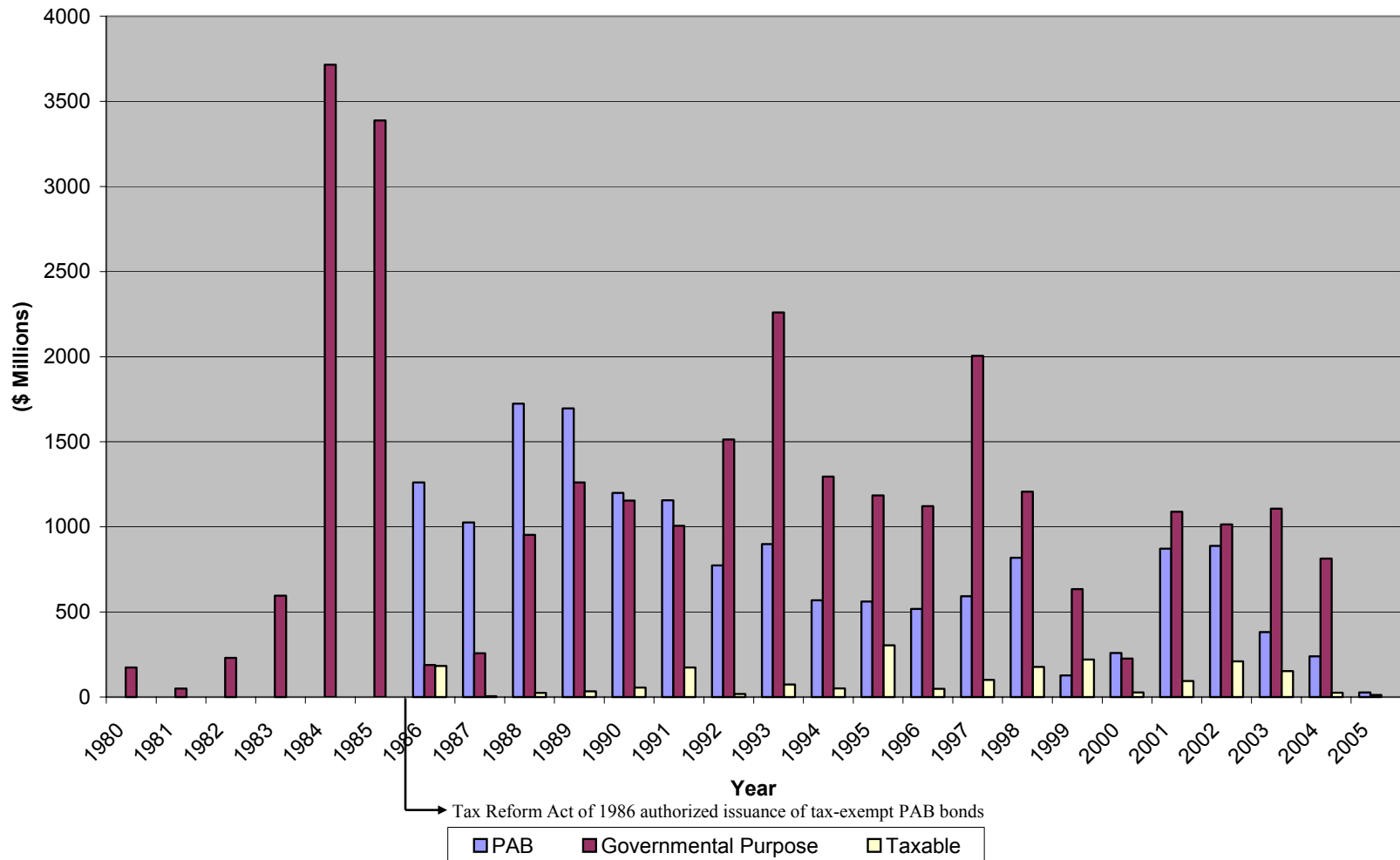


Average Issuance/Year (\$ Millions)

PAB	\$238
Governmental Purpose	\$18,838
Taxable	\$220

Solid Waste Historical Data

Transaction Amounts Over Past 25 Years

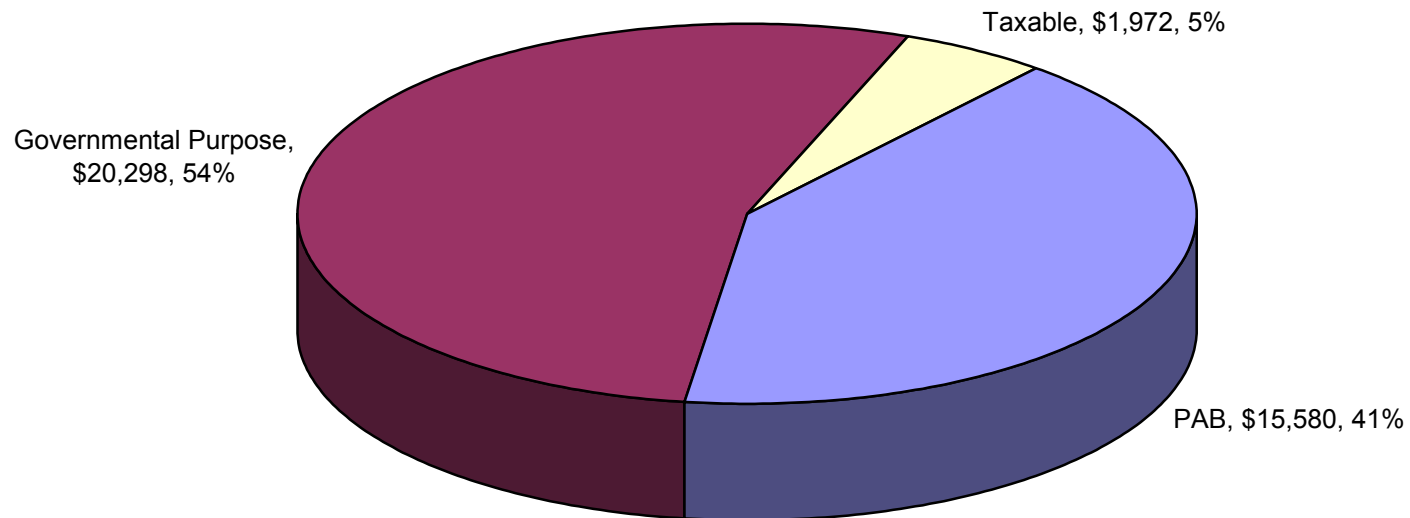


Solid Waste Historical Data

Solid Waste Transaction Allocation (\$ Millions)

Total Issuance: \$37,850 Million

Years: 1986-2005



Average Issuance/Year (\$ Millions)	
PAB	\$779
Governmental Purpose	\$1,015
Taxable	\$99

Projected Water/Wastewater PAB Issuance

- Solid waste PAB issuances have equaled 41% of total solid waste issuances compared to 1% for water/wastewater since 1986
- Average total solid waste PAB issuances/year equaled \$779 million compared to \$238 million for water/wastewater since 1986
- Based on experience in the solid waste sector, we believe PAB issuance for water/wastewater projects would significantly increase and help expedite construction of new projects
- Actual issuance of PAB's for water/wastewater projects will be based on the number of projects ready to be financed, particularly where the public sector wants the private sector to assume a greater role in assuming development, technology and performance risk
- With the elimination of bond cap for water/wastewater projects, it is reasonable to expect that \$1 to \$2 billion of PAB's would initially be issued annually and could double or triple annually over time as the PPP water/wastewater industry matures

Projected Water/Wastewater PAB Issuance

- Tested and proven tax-exempt bond financing structures exist to finance public-private partnerships for water/wastewater infrastructure
- Projects can be structured as public-private partnerships to optimize development, construction and long term operation, as well as appropriate sharing of risks between the public and private partners
- Highly-regarded private companies active in the water/wastewater market facilitate the structuring of long-term public-private partnerships
- Long term private partner risk assumption and equity investment for water/wastewater projects would increase with the use of PABs and benefit all public and private participants developing projects to meet water quality infrastructure needs

Conclusion

In closing, Mr. Chairman, I want to re-emphasize the fact that we need to approach our water quality infrastructure funding gap with an open mind. The traditional ways of doing business do not provide an adequate level of funding support nor will such mechanisms suffice to meet the challenges of emerging water quality compliance mandates. We need to finance using creative mechanisms that will help communities comply with environmental mandates in as cost-effective manner as possible as we did during the 1980's solid waste disposal crisis which is now largely behind us due in part to the availability of PABs. PABs are just one tool, but an important one, that will provide our water quality administrators the ability to begin to meet the challenges of the next several decades. Mr. Chairman, this concludes my formal testimony. I would be pleased to answer any questions that the Subcommittee may have.